

Responses of David G. Noren to

Rep. Richard Neal's Questions for the Record

November 2011 Select Revenue Measures Subcommittee Hearing on the Ways and Means Committee's International Tax Reform Discussion Draft

Rep. Neal's questions:

The Camp territorial proposal retains current law subpart F, which taxes U.S. shareholders of foreign corporations on their share of certain types of income earned by the foreign corporation, even though the income has not been repatriated. Current law (section 961) permits U.S. shareholders to increase the tax basis of their stock by the amount of the Subpart F inclusions. This adjustment prevents double taxation of the subpart F income that would occur if the shareholder recognizes a gain upon a future sale of the stock.

The Camp proposal would repeal the basis increase. This would adversely affect U.S. companies that have paid tax as a result of Subpart F inclusions and would pay tax again upon any gain realized from a future sale of their stock. Do you see this as an issue? If so, how would you address it?

Would transition rules mitigate the negative impacts (outbound transfers, branch loss recaptures) of treating foreign partnerships and branches as CFCs? How would you craft such transition rules? There is a concern by some companies that the Camp proposal would accelerate tax.

David Noren's responses:

I do see the proposed repeal of both the "previously taxed earnings" rules of section 959 and the related basis adjustment rules of section 961 as an issue. Repealing these rules would effectively cause subpart F income to be taxed more heavily than purely domestic income, which I do not think is warranted. I would recommend preserving both sets of rules under a territorial dividend exemption system.¹

Regarding the proposal to treat first-tier foreign branches and (under regulatory authority) certain foreign partnerships as CFCs, assuming that such a proposal is enacted, I do think that special transition rules would be needed to mitigate "negative impacts" of the kind that Rep. Neal describes. I would recommend transition rules that would provide that the conversion of a branch (or partnership) into a deemed CFC would not give rise to a taxable outbound transfer of any property that was held or used by the branch or partnership prior to the introduction of the new system. Such an approach would mitigate the transition impact of introducing the deemed-CFC rules, without undermining the purposes of those proposed rules (assuming the rules are needed in the first place).

¹ See David G. Noren, "The Ways and Means Committee International Tax Reform Discussion Draft: Key Design Issues," 41 Tax Mgmt. Int'l J. (BNA) 167, 175-76 (April 2012).